



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

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Date:	05/06/14	Bill No:	<a href="#">Senate Bill 998</a>
Tax Program:	Sales and Use Tax	Author:	Knight
Sponsor:	Author	Code Sections:	RTC 6377.1
Related Bills:	AB 1997 (Gorell)	Effective Date:	Upon enactment

## BILL SUMMARY

Among other things, this bill specifies that manufacturing and research and development equipment purchased for use in a new aerospace project, as defined, shall not be considered for purposes of the \$200,000,000 limit.

## ANALYSIS

### CURRENT LAW

Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law<sup>1</sup> imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state or the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer.

Beginning July 1, 2014, and until July 1, 2022, existing law<sup>2</sup> provides manufacturers, and certain other qualified persons, a 4.1875% state sales and use tax exemption for their qualifying tangible personal property purchases. The 4.1875% exemption rate includes only two components of the overall statewide sales and use tax rate of 7.5%. This includes the 3.9375% state General Fund rate, and the 0.25% state Education Protection Account rate.

This provision limits the allowable exemption to \$200 million in qualifying purchases each calendar year by each qualified person or by all qualified persons required or authorized to be included in a combined report under the Corporation Tax Law.<sup>3</sup>

This partial sales and use tax exemption applies to a "qualified person's" purchases of qualified tangible personal property:

- To be used primarily in manufacturing, processing, refining, fabricating, or recycling of property (i.e., machinery, equipment, parts, belts, shafts, computers, software, pollution control equipment, buildings and foundations), as specified.
- To be used primarily to maintain, repair, measure, or test any qualified tangible personal property.
- Purchased by a contractor, as specified, for use in the performance of a qualified person's construction contract. The qualified person must use the property, however, as an integral part of any manufacturing, processing, refining, fabricating, or recycling process or as a research or storage facility in connection with the manufacturing process.
- To be used primarily in research and development.

<sup>1</sup> Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code (RTC).

<sup>2</sup> RTC Section 6377.1.

<sup>3</sup> RTC Section 25101 or 25101.15.

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The law excludes from the “qualified person” definition, an apportioning trade or business that is required to apportion its business income pursuant to specified provisions, or a trade or business that would be required to apportion business income under those provisions if it apportioned its income. This includes, among other things, business activity relating to the production, refining, or processing of oil, natural gas, or mineral ore and specified agricultural activities.

This partial sales and use tax exemption excludes:

- Consumables with less than a one year useful life,
- Furniture, inventory, equipment used in the extraction process or equipment used to store finished products that have completed the manufacturing process, and
- Tangible personal property primarily used in administration, general management, or marketing.

**California’s sales and use tax rates.** California imposes a statewide 7.5% sales and use tax on tangible personal property sales and purchases. The table below shows California’s various sales and use tax rate components (the table excludes voter-approved city and county district taxes):

Rate	Jurisdiction	Purpose/Authority
3.9375%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
1.0625%	Local Revenue Fund 2011	Realignment of local public safety services (RTC Sections 6051.15 and 6201.15)
0.25%	State (Fiscal Recovery Fund)	Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5)
0.25%	State (Education Protection Account)	Schools and community college funding (Section 36, Article XIII, State Constitution) (until 01/01/17)
0.50%	State (Local Revenue Fund)	Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)
0.50%	State (Local Public Safety Fund)	Local governments to fund public safety services (Section 35, Article XIII, State Constitution)
1.00%	Local (City/County) 0.75% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.50%	Total Statewide Rate	

### PROPOSED LAW

Among other things, this bill specifies that manufacturing and research and development equipment purchased for use in a new aerospace project, as defined, shall not be considered for purposes of the \$200,000,000 qualifying purchase limit.

The bill defines “new aerospace project” to mean the manufacturing, design, or testing of aircraft, aircraft engine, guided missiles, space vehicles, propulsion units, or related parts or components by the qualified taxpayer, pursuant to a contractual agreement between the qualified taxpayer and a purchaser, that commences in this state on or after January 1, 2015, and has not commenced outside of this state prior to that date.

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This bill also amends the Personal Income Tax Law and Corporation Tax Law, which fall under the purview of the FTB and are not discussed in this analysis.

The bill becomes effective immediately upon enactment.

### BACKGROUND

In 2013, the Governor approved an economic development plan that made various changes in the state tax system.<sup>4</sup> The statutory changes were related to the Governor's Budget to address budgetary aspects of one of the state's largest and fastest growing tax expenditure programs, and provide additional tax incentive programs to encourage economic development. The 4.1875% sales and use tax exemption that applies to manufacturers was created under that plan.

Also during the 2013 Legislative Session, and prior to this plans' enactment, AB 1326 (Gorell and Bradford) was introduced to provide unmanned aerial vehicle manufacturers a full sales and use tax exemption on their qualifying tangible personal property purchases, until January 1, 2024. The Assembly Appropriations Committee held the bill.

### COMMENTS

- 1. Sponsor and Purpose.** As sponsor, the author notes, "SB 998 helps to position California as an attractive state to expand upon new aerospace manufacturing and create thousands of jobs in this era of high unemployment. Beyond helping the businesses that may be awarded new DOD contracts, the multiplier effect to hundreds of small suppliers in this state is a win-win for all Senate and Assembly districts across California."
- 2. Bill's enactment would not materially affect the BOE's operations.** The removal of the \$200 million limitation does not add complexity to the BOE's administration of the partial sales and use tax exemption.
- 3. Related legislation.** AB 1997 (Gorell) provides a full sales and use tax exemption (rather than the current 4.1875%) for qualifying tangible personal property purchases by manufacturers of unmanned aerial vehicles.

### COST ESTIMATE

We anticipate insignificant costs to notify affected retailers, audit claimed exemptions, and respond to inquiries from taxpayers and the general public.

### REVENUE ESTIMATE

Pending.

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Analysis prepared by:	Sheila T. Waters	916-445-6579	05/09/14
Contact:	Michele Pielsticker	916-322-2376	
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<sup>4</sup> AB 93 (Ch. 69, Stats. of 2013) and SB 90 (Ch. 70, Stats. of 2013).

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